2011 tax tips for

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ophthalmologists

With the top marginal tax rate set at 35% for this year, every dollar you don't pay in taxes will save you at least thirty-five cents in that bracket. If you live in one of the many states with an income tax, you could save even more. The end of the tax year is at hand, so now is the perfect time to call your tax advisor and work through some tactics to trim your tax bill. The following tips may offer you some sweet opportunities.

Plug in and save. With gas prices topping $4 per gallon in parts of the country, you might be tempted to buy a hybrid, but the real tax savings are currently (no pun intended) in electric cars. When you buy a vehicle certified for the Qualified Plug-In Electric Drive Motor Vehicle Credit, you can save up to $7,500 in taxes. Andrew Schwartz is a certified public accountant in Boston, and author of a monthly tax newsletter for healthcare professionals at www.MDTaxes.com. He said, "This is a great tax break for doctors since it's not limited by the Alternative Minimum Tax (AMT) like the credit for hybrids was." Mr. Schwartz noted that many of his firm's married clients were hit by the AMT in 2010, making the credit particularly valuable for doctors who are in a position to purchase electric. To avoid a shock at tax time, consult your tax advisor BEFORE you step into the dealer's showroom.

Open a health savings account (HSA). The health savings account was established in 2003 as an additional tool to help Americans save for medical expenses in a tax-sheltered environment. If your circumstances qualify you for it, an HSA can be a particularly handy tax management tool for physicians. You will never pay taxes on the money (as long as you follow the rules): Contributions are tax-deductible to begin with, they grow tax-deferred, and qualified withdrawals are tax-free. In 2011, you can set aside up to $3,050 in potential medical expenses for yourself, or if you have a family plan, you can contribute up to $6,150. As an added twist, you don't necessarily have to spend it right away. You can let the money grow tax-deferred indefinitely by paying your healthcare expenses out-of-pocket instead of taking the money out of your HSA.

Before you rush to call your existing insurance broker, know that you can purchase your health savings account and health savings insurance (i.e., your HSA-eligible, high-deductible health plan, or HDHP) from two separate vendors. It can be advantageous to consider separate, best sources for each; by shopping around, you may be able to reduce administrative and investment expenses and improve your investment selections.

Invest in equity index funds. While we're on the subject of investment selections, whether you're investing in tax-sheltered accounts such as an HSA or in taxable accounts, I recommend viewing your investment activities from a portfolio-wide perspective. The object is to build and maintain an overall portfolio that (1) reflects your personal goals and risk tolerances, (2) uses broad diversification to minimize unnecessary risks, and (3) accomplishes numbers 1 and 2 while keeping costs low.

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It's tempting for physicians to pursue fancier investments, but the truth is, "fancy" is all too often a synonym for expensive and overly complicated, without adding any expected value in return. Instead, consider simple index funds from The Vanguard Group for retail investors, or passively managed funds from Dimensional Fund Advisors for physicians using an approved advisor. Either way, you can accomplish all three goals above with minimal complexity. And if you hold your funds, rather than fleeing from them during times of market volatility, you can defer capital gains and keep your tax return simple. Your tax advisor will love you for it.

Turn your losing investment into a winning tax move. If one of your investments turned out to be a lemon, you can "make lemonade" by selling it for a loss. If you've lost $3,000 or more on an asset such as a stock or mutual fund, you can sell before year-end to "recognize" the loss, and offset up to $3,000 worth of ordinary income this year. If you lost more than $3,000, you can "carry forward" your losses into future years to offset future gains or income.

Give your gains to charity for good. On the flip side, if you're charitably minded and you've got an asset that has appreciated significantly in value, consider donating the asset "in kind" to a qualified charity. For example, say you own 100 shares of the XYZ Fund that you bought at $50/share, and now it's worth $75/share. If you sold the fund, you'd owe tax on the $2,500 gain. If you instead gifted the fund to charity (without selling), you'd sidestep the capital gains tax, plus qualify for a tax deduction on your gift. Since it is a non-profit organization, your charity won't owe taxes on the gift either. The same strategy applies to most assets, including stocks, bonds, mutual funds, or real estate. If you are going to make a donation anyway, you may as well maximize your tax advantage. The devil is in the details, so consult your tax and financial advisors first.

Save taxes as you save for your kids' college. As you set aside funds for your children's or other beneficiaries' higher education, consider contributing to a Section 529 college savings plan where the investments can grow tax-deferred and be spent tax-free for qualified higher education expenses.

Most states offer their own 529 plan; you may use your state's plan, but you are not obligated to. In deciding which plan is best for you, consider factors such as the state-tax benefits your state offers, as well as the quality and expense ratios of the funds available within the plan. Bill Cleveland, a certified public accountant with Preston & Cleveland Wealth Management, Augusta, Ga., commented, "As with all investing decisions, when comparing 529 plans, make sure you understand the cost/benefit ratio. These aren't like cuts of meat, where the more you spend, the higher quality you get. Costs vary widely, especially between direct-sold and broker-sold plans. Sometimes less is more."

One of the best places to begin your research is at www.savingforcollege.com, a comprehensive and objective source for clearly disclosed information on 529 plans.

Working two jobs? Set up a separate retirement plan. If you're waiting to make partner in your practice, you might not be covered by your employer's retirement plan yet. This means you might be eligible to establish your own SEP-IRA, where you can contribute earnings from a second job—such as teaching or working *locum tenens*. SEPs are easy to establish and, depending on your circumstances, you may be able to contribute up to $49,000 for 2011.

Add your spouse to your practice payroll. Even if your spouse is employed elsewhere, as long as he or she is not already covered by a qualified retirement plan, he or she can contribute up to $11,500 to your SIMPLE IRA ($14,000 if 50 or older) or up to $16,500 to your 401(k) ($22,000 if 50 or older). Accounts under both plans get more than a tax break; they gain protection from creditors under the Bankruptcy Abuse Prevention Act (BAPA). If your spouse is a practice employee, be certain to document duties and services performed, and pay an appropriate wage.

Take interest in your debts. If you have auto loans, credit card debt, or other consumer debt—or if you have student loans and you earn too much money to take the student loan interest deduction—consider refinancing these debts with a second mortgage or a home equity line of credit (HELOC). For most physicians, interest on the first $100,000 of "non-acquisition home equity indebtedness" (loans against your house that you didn't use to buy the house) can be taken as itemized deductions and could save you several thousand dollars in taxes. Also, HELOCs and second mortgages tend to bear lower rates than consumer debt. Be certain to stay current on payments to avoid foreclosure. Also, don't sustain debt simply to avoid taxes; work closely with your financial planner to optimize your overall debt management plans.

Invest in your business. If you can't choose between two new pieces of equipment, you might want to get off the dime and decide before year-end. For example, if you've been thinking about adding a HOYA iTrace Surgical Workstation (Hoya Surgical Optics, Chino Hills, Calif.) or a Nidek OPD (Nidek, Fremont, Calif.) (40-45 K), or an IOL Master 500 (Carl Zeiss Meditec, Dublin,

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Calif.) or a Haag-Streit LENSTAR (Haag-Streit, Mason, Ohio) (30-34 K) to your armamentarium in the surgical suite, now may be a great time to make that upgrade and invest in your practice.

Thanks to various government stimulus measures, the Section 179 deduction for business equipment purchased in 2011 has been raised to $500,000. You may not speak IRS-ese, so let me tell you that the Section 179 deduction means you can expense an entire purchase this year, rather than spreading the expense—and the tax savings—over several years. For a summary, visit www.section179.org/stimulus_acts.html.

Refresh your retirement plan. If your office uses a SIMPLE IRA or a safe-harbor 401(k) plan, it might be time for a new plan: the New Comparability Plan. Pension consultants will tell you it's a cross-tested defined-contribution retirement plan for discretionary profit-sharing contributions. But what it does for you is not nearly as obscure as its description. Simply put, it treats highly compensated employees (doctors) more favorably than employees who earn less (staff) by allowing you to put more money into your account than traditional plans do—without breaking rules designed to ensure fairness to all participants. Even though the Treasury Department formed these plans more than a decade ago, implementation is complex, so the adoption rate has been slow among small businesses. If you don't have time to explore this option, and you don't have a consultant who can do it for you, visit the American Society of Pension Professionals & Actuaries (www.asppa.org) and find a consultant to assist with the heavy lifting.

Layer on the tax savings. "To make retirement savings even less taxing, you could layer a cash balance defined benefit plan on top of your new comparability plan," said Jeff Curl, Summit Benefit & Actuarial Services, Wauwatosa, Wis. According to Mr. Curl, "You can get contributions two to four times higher than what might fit in the new comparability plan, perhaps up to $200,000 for highly compensated doctors." Mr. Curl warned that these plans are only appropriate for consistently profitable businesses, as may be the case with larger, more mature ophthalmology practices. But if you explore cash balance plans, watch out for plans that involve life insurance. "They might be a good plan for the guy selling the insurance, but they might not be the best plan for the doctor," said Mr. Curl.

Contribute to your IRA. Remember the good old days in residency when you worked your tail off and made so little that you could actually deduct your IRA contributions? In the grand scheme, it's actually a good thing that those days are gone forever, but you can still make non-deductible contributions to a traditional Individual Retirement Account.

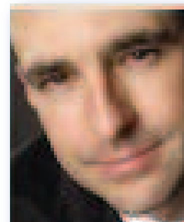
Janet Davis, a certified public accountant with Trusted Advisors Consulting, Tucson, Ariz., said, "The Roth conversion is still available to tax payers in 2011 and later years, regardless of income. Even though you can't deduct your IRA contributions, it's still a great idea to make them, so you can convert the IRA later. It makes those IRA contributions even more powerful."

Ms. Davis is referring to the fact that the Roth IRA conversion option is currently available to high earners, which means you can convert your Traditional IRA account to a Roth, pay the taxes on the conversion upfront, and let your earnings grow tax-free for the rest of your life. Physicians under age 50 can contribute $5,000 to an IRA for themselves and an additional $5,000 for a non-earning spouse (make that $6,000 if you're 50+), and you can make your 2011 contribution any time before you file your return, which may be April 15 of next year.

When and how to make these sorts of conversions can get pretty complicated pretty fast, especially once you factor in tax-efficient estate planning. However, properly managed, they can be of significant value to your bottom line, so they're worth considering.

Keep an eye out for Alternative Minimum Tax (AMT). "Physicians earning $200,000–$400,000 per year often wind up paying the Alternative Minimum Tax," said Ms. Davis. Doctors in the AMT may want to take advantage of the 28% AMT bracket by converting to a Roth IRA, taking deferred compensation, or making other moves to accelerate income into 2011. After all, tax rates are set to rise in 2013, making that 28% rate look like a bargain by comparison.

Remember that most tax breaks come at a price, like increased expenses (interest paid, purchases made, or assets simply given away) or deferred gratification (saving for college and retirement). At best, tax breaks are sweeteners to help you make an otherwise sour decision, and they may motivate you to do something that's actually more expensive than the alternative, like buying a brand new car instead of a good used one. In the end, tax maneuvers are just one more tactic you can use in your financial plan, so keep your goals in mind and stay focused on reaching them. **OB**



Mr. Utley helps young doctors get on track with a personalized one-page plan to pay off debt, save for college, and invest wisely for retirement. Physician Family Financial Advisors Inc. delivers fee-only financial planning and independent investment management to clients coast-to-coast from its headquarters in Eugene, Ore. Visit www.physicianfamily.com or call 541-463-0899.